No. 304

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IN THE

Supreme Court of the United States

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioners,

against

IRVING TRUST COMPANY, as Trustee in Bankruptcy of EXPERIMENTER PUBLISHING CO., INC., Bankrupt,
Respondent.

MOTION FOR CERTIORARI, PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

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BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

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Supreme Court of the United States

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioners,
against
IRVING TRUST COMPANY, as Trustee in Bankruptcy of EXPERIMENTER PUBLISHING CO., INC., Bankrupt,
Respondent.

MOTION FOR CERTIORARI.

Comes, now, the petitioners, The People of the State of New York, with Robert P. Beyer, Esq., as counsel, and moves this Honorable Court that it will by certiorari or other proper process directed to the Honorable Circuit Court of Appeals for the Second Circuit, requiring said court to certify to this court for its review and determination a certain cause in said Circuit Court of Appeals lately pending entitled "In the Matter of Experimenter Publishing Co., Inc., Bankrupt, The People of the State of New York, Appellant, Irving Trust Company, as Trustee in Bankruptcy, Appellee" and to that end your petitioners now tender herewith their petition and brief, with a certified copy of the record in said Circuit Court of Appeals.

ROBERT P. BEYER,
Attorney for Petitioner,
Office and Post Office Address,
80 Center Street,
New York City, N. Y.

Petition.

SUPREME COURT OF THE UNITED STATES.

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioners,

against

IRVING TRUST COMPANY, as Trustee in Bankruptcy of EXPERIMENTER PUBLISHING CO., INC., Bankrupt,
Respondent.

To the Honorable Chief Justice and Associated Justices of the Supreme Court of the United States:

The petitioners, The People of the State of New York, respectfully show to this Honorable Court:

First: That there is pending in the District Court of the United States for the Southern District of New York a certain bankruptcy proceeding entitled "In the Matter of Experimenter Publishing Co., Inc., Bankrupt," the bankrupt having been thus adjudicated March 6th, 1929. The proceedings were referred generally to Peter B. Olney, Jr., referee in bankruptcy of said District Court. The respondent, Irving Trust Company, was duly selected trustee of said bankrupt.

Second: Franchise taxes for the tax years beginning November, 1927, and November, 1928, based on reports filed for or on behalf of the bankrupt with the New York State Tax Department were duly assessed on behalf of the petitioner, with respect to which there is no question presented to this Court.

Section 219-d of the Tax Law of the State of New York provides:

> "If the amount of the net income for any year of any corporation taxable under this article as returned to the United States treasury department is changed or corrected by the commissioner of internal revenue or other competent officer of the United States, *or other competent authority,* such corporation, within ten days after the receipt of notice of such change or correction, shall make return under oath or affirmation to the tax commission of such changed or corrected net income and shall concede the accuracy of such determination or state wherein it is erroneous."

The section then provides for a reaudit of the tax, and concludes:

> "If from such reassessment it appears that an additional tax is due from such corporation for such year, such corporation shall, within thirty days after notice has been given as provided in section two hundred and nineteen b of this chapter, pay such tax."

THIRD: Under interpreting decisions of the Court of Appeals of the State of New York (Engelhardt vs. Alvine Realty Company, Inc., 248 N. Y. 374; Carey vs. Keith, Inc., 250 N. Y. 216) such possible increased tax liability, by reason of an occurring increased assessment on income by the Federal government, is a lien on the property of the corporation as of the date when the tax should have been paid, although subject to subsequent ascertainment as to amount.

FOURTH: On July 1, 1929, the referee, on a petition of the trustee, made an *ex parte* order directing the State of New York to file, within sixty days after service of a copy of said order, with notice of entry, proof of any and all claims which the State of New York might have against the estate of the bankrupt or be forever barred from asserting any such claim either against the bankrupt's estate, against the trustee or the funds in the hands of the trustee. A copy

of the order, with notice of entry, was served on the State Tax Commission on July 18th, 1929.

FIFTH: On October 20th, 1929, the State of New York filed with the referee in bankruptcy, a notice of an unliquidated claim for additional franchise taxes as follows:

"UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK.

In the Matter of EXPERIMENTER PUBLISHING CO., INC.	*Bankruptcy No. 46582.* *Peter B. Olney, Jr., Referee,* *7 Dey Street,* *New York, N. Y.*

PLEASE TAKE NOTICE that the State of New York has an unliquidated claim for franchise taxes against the above named bankrupt for the tax years beginning November 1st, 1928, also additional franchise taxes as imposed by Section 219 D, Article 9 a, of the Tax Law, for tax years beginning November 1st, 1917, to 1928, inclusive, together with interest, the exact amount of such taxes and interest being unknown at the date hereof. Claim will be filed as soon as the necessary franchise reports can be obtained or such other information as may be necessary to fix and determine such tax or taxes.

PLEASE TAKE NOTICE that annexed hereto is a Notice of Unliquidated Claim for Franchise Taxes due the State of New York, and for which the State of New York claims a preference over and above all the debts of the said bankrupt and claims submitted to you.

Dated, 10/17/29.

HAMILTON WARD,
Attorney General of the State of New York.

Filed October 20th, 1929."

No objection at the time was made to the filing of the claim.

SIXTH: This claim was filed because an examination of the schedules, made by Charles W. Hutchins, Corporation Tax Examiner, disclosed that the United States Government had filed claims for additional taxes based on a net income greater than as reported by the corporation.

SEVENTH: On the date of filing of said claim no distribution of the bankrupt's estate had been made. Final distribution has not been made to date. The trustee has sufficient assets to pay the taxes due the State of New York, should a proper reaudit disclose liability therefor.

EIGHTH: The trustee did not move to expunge the claim until March 30th, 1931. A motion to expunge was made returnable before the referee on April 9th, 1931. In the determination of the referee, no exception was taken to the claim as such. In fact the referee in his opinion stated:

> "The Bankruptcy Act contemplates the filing of unliquidated claims and the process for their liquidation in such manner as the court shall direct and thereafter for their proof and allowance against the bankrupt estate. Section 63 B."

The motion to expunge was granted on the sole ground that the claim was filed after the limitation of time prescribed by the bar order. The referee held that the claim should have been filed prior to September 16th, 1929, the date fixed in the bar order.

NINTH: On petition for review, District Judge Coleman affirmed the referee's determination, on the sole ground that the same was filed one month and four days after the time limited by the bar order.

TENTH: The petitioners duly appealed to the United States Circuit Court of Appeals for the Second Circuit, which said Court affirmed the order expunging said claim of the petitioners by decision rendered May 23rd, 1932. Thereafter and on or about the 23rd day of June, 1932, a mandate of the said Circuit Court of Appeals was duly filed in the District Court of the United States for the Southern District of New York.

ELEVENTH: That the petitioners are not in a position to file any actual claim for any additional tax liability until after proper reaudit by the referee in bankruptcy for additional tax liability owing to the Federal Government, based upon a determination of the correct income of the bankrupt for the tax years in question. The allowance of additional taxes to the Federal Government will also result in establishing additional tax liability to the State of New York.

TWELFTH: The State of New York is sought to be precluded from the filing of its claim by a so-called Bar Order, requiring the State to file any claim which it has against the estate in bankruptcy within sixty days from the date of service of said order or be thereafter precluded from the filing of such claim. Such order was not made pursuant to any statutory authority, but solely as a result of a practice rule in bankruptcy cases. The power and authority of a referee in bankruptcy to make such an order has never been passed upon by this Court. Likewise, this Court has never passed on the power and authority of a referee in bankruptcy of the District Court to preclude a sovereign state from filing a tax claim after the expiration of the time limited in said Bar Order, even though there remains in the hands of the Trustee undistributed assets

more than sufficient to pay the asserted tax claim, if and when established.

THIRTEENTH: The proper determination of the question presented is of paramount public importance, involving not only the determination of the question whether the sovereign power of the State can be thus constitutionally limited, but also whether the sovereign State can be thus arbitrarily precluded from establishing its claim through the prescribed statutory procedure in cases where there are sufficient assets remaining undistributed to pay such tax liability when established. The questions involved will recur for determination in innumerable future bankruptcies. The final determination thereof by this Court is not only of paramount public importance to the tax system of the State of New York but likewise to every other state having tax statutes similar to that of your petitioner State.

FOURTEENTH: The following are the questions which, it is respectfully submitted, should receive finality of adjudication:

Question No. 1—Has the United States District Court or a referee in bankruptcy the constitutional power and authority to make an order in a bankruptcy proceeding requiring a sovereign state to file tax claims with the referee in bankruptcy within a prescribed definite period or be thereafter barred from filing any such claims?

Question No. 2—Where a referee in bankruptcy makes an order requiring a state to file any tax claim within sixty days after the service of a copy of said order, and where the State files a claim for additional taxes one month and four days after the expiration of the time limited by said order, which said claim was permitted to remain on file with the referee for a period of one year and five

months from the date of filing before any motion was made to expunge the same because not filed in time, has the referee in bankruptcy the constitutional right and authority to grant a motion to expunge said claim because not filed within the time prescribed in said order in a case where there are sufficient undistributed assets of said bankrupt to pay the said claim in full, upon the same being established as to amount by the referee in bankruptcy.

Question No. 3—In a case where a referee in bankruptcy makes an order requiring a state to file any tax claim within a period of sixty days from the date of service of said order; where the state files a claim for possible increased franchise taxes, determinable as to amount on a reaudit of income for the tax years in question made in connection with the claims for additional tax liabilities for the same year filed by the United States Government, said claim being filed by the State one month and four days after the expiration of the time limited by said order; where said claim is permitted to remain on file with the referee in bankruptcy for a period of one year and five months before any motion is made to expunge same, has the referee in bankruptcy the constitutional power and authority to grant a motion to expunge said claim because not filed within the period prescribed in said order, without making a determination as to the amount of income earned by the bankrupt in the tax years in question in connection with additional tax claims filed by the United States Government, and without, by this method, determining the true amount of taxes due by the bankrupt to the State, in a case where there are undistributed assets of the bankrupt more than sufficient to pay such tax liability as thus adjudicated to the State in full?

FIFTEENTH: The questions stated should each be answered in the negative in order that the sovereignty of the State, as interpreted by this Court in Marshall vs. State of New York, 254 U. S. 380, may be maintained and preserved.

WHEREFORE your petitioners respectfully pray that a writ of certiorari may be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that court to certify and send to this Court on a day certain to be thereafter designated, a full, true and complete transcript of the record and of all the proceedings in said Circuit Court of Appeals in the said cause therein entitled "In the Matter of Experimenter Publishing Co., Inc., bankrupt, The People of the State of New York, appellant, Irving Trust Company, as trustee in bankruptcy, respondent", to the end that said cause may be reviewed and determined by this Court as provided in Section 6 of the Act of Congress entitled "An Act to establish a Circuit Court of Appeals and to define and regulate in certain cases the jurisdiction of the Courts of the United States, and for other purposes", approved March 3rd, 1891 (26 Stat. 826, Chap. 517), and that your petitioners may have such other and further relief or remedy in the premises as to this Court may seem appropriate and in conformity with said act, and that the decree of the United States Circuit Court of Appeals for the Second Circuit in said cause and of the District Court of the United States for the Southern District of New York, and each and every part thereof may be reversed by this Honorable Court and the Referee in Bankruptcy herein be instructed and ordered to receive and file

the unliquidated claim of the State of New York expunged by the orders objected to.

And your petitioners will ever pray.

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioners.
By JOHN J. BENNETT, JR.,
Attorney General of the State of New York.

ROBERT P. BEYER,
Counsel for Petitioners,
80 Center Street,
New York City, N. Y.

State of New York, }
City of New York, } ss.:
County of New York. }

ROBERT P. BEYER, being duly sworn, deposes and says: That he is Deputy Assistant Attorney General of the State of New York and is counsel for the petitioners herein. That he has prepared the foregoing petition and that the allegations therein are true as he verily believes.

ROBERT P. BEYER.

Sworn and subscribed before me this
10th day of August, 1932.
Henry Unterweiser,
Notary Public, Bronx County.
Bronx Co. Clk's No. 1, Reg. No.
N. Y. Co. Clk's No. 8, Reg. No. 4U7.
Kings Co. Clk's No. 7, Reg. No. 4002.
Queens Co. Clk's No. 602, Reg. No. 2827.
Commission expires March 30th, 1934.

SUPREME COURT OF THE UNITED STATES.

THE PEOPLE OF THE STATE OF NEW YORK,
Petitioners,

against

IRVING TRUST COMPANY, as Trustee in Bankruptcy of EXPERIMENTER PUBLISHING CO., INC., Bankrupt,

Respondent.

PETITIONERS' BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The petitioners, The People of the State of New York, petition this Honorable Court to review by certiorari an order of the Circuit Court of Appeals for the Second Circuit made final under Section 7 of an Act of Congress entitled "An Act to Establish a Circuit Court of Appeals, and to review and regulate in certain cases the jurisdiction of the Courts of the United States, and for other purposes", approved March 3rd, 1891 (26 Stat. 826, Chap. 517).

This case involves important questions effecting State sovereignty and the power and authority of a District Court of the United States to limit such sovereignty by court rule. The questions are stated at length in the petition. They have not received finality of adjudication by this Court. Such finality of determination is not only of paramount importance in the proper administration of the bankruptcy law but to the several states in the administration of their respective taxing systems.

The determination of the Courts below are further in conflict with decisions of this Court and federal courts of other circuits.

The petitioners contend that the order of the Circuit Court of Appeals is erroneous in failing to recognize and apply the following well established principles duly interpreted by this Court and Circuit Courts of other circuits:

(1) A Federal Court cannot divest a State of its sovereign tax functions by means of a Court rule not based on statutory authorization.

(2) No State can be barred, by any Court rule, from asserting a tax liability due it from a bankrupt prior to final distribution of the estate.

(3) No State can be barred by any Court rule from filing a claim with a referee in bankruptcy for a possible increased tax obligation, the law making it the duty of the referee in bankruptcy to make an audit from which such liability may be properly determined.

POINT I.

The judicial requirement to the state to file a claim for taxes within a specified period or be thereafter barred from filing such claim is an unconstitutional infringement of state sovereignty.

Sovereignty of states is described in 36 Cyc. 928 as follows:

> "Prior to the formation of the federal constitution, the states were sovereigns in the full absolute sense of the term; but, under the constitution, their sovereignty stops short of nationality, and their political status at home and abroad is that of states of the United States.—The states are sovereigns within their separate spheres as to all powers not delegated to the United States or prohibited to the states, and, subject to these restrictions, each state is supreme and pos-

sesses exclusive right of regulating its own affairs, and in all matters relating to the life, liberty and property of citizens the state is sovereign as long as it does not conflict with the federal constitution.

Thus, except as restrained by the federal constitution, states may—exercise the taxing power or, in general, may exercise any power possessed by them prior to the adoption of the constitution unless the exercise of such power is expressly or by necessary implication prohibited by the constitution and interferes with the exercise of some power delegated to the United States."

As well stated in Lowenstein vs. Evans, 69 Fed. 908, 911:

"The state is a sovereign having no derivative powers, exercising its sovereignty by divine right. The state gets none of its powers from the general government. It has bound itself by compact with other sovereign states not to exercise certain of its sovereign rights, and has conceded these to the Union, but in every other respect it retains all its sovereignty which existed anterior to and independent of the Union."

As applicable to the state sovereign right of taxation, specific reference is made to the able and elaborate opinion of Chief Justice Marshall in Gibbons vs. Ogden, 22 U. S. 1 and to the following quoted extract therefrom:

"The grant of power to levy and collect taxes is, like the power to regulate commerce, made in general terms, and has never been understood to interfere with the exercise of the same power by the states."

And, as stated in State Treasurer vs. Wright, 28 Ill. 509:

"The jurisdiction of the State on the subject of taxation for State purposes is supreme and the government of the United States can have no power or control in this regard."

In accord, see Frick vs. Pennsylvania, 268 U. S. 473, 499; Baltimore vs. Gill, 50 Md. 377; Catlin vs. Hull, 21 Vt. 152; Whiteaker vs. Haley, 2 Ore. 128; Stein vs. Mobile, 17 Ala. 234; Curry vs. Wilson, 57 Wash. 367; U. S. vs. Douglas, 3 Wyo. 287.

Such prerogative right has been frequently recognized and enforced.

In Marshall vs. State of New York, 254 U. S. 380, wherein this Court directed the payment of a claim for taxes as a preferred debt, Mr. Justice Brandeis, for a unanimous Court, stated:

> "This priority arose and existed independently of any statute. The legislature has never, in terms, limited its scope; and the Courts have rejected as unsound every contention made that some statute before them for construction had, by implication, effected a repeal or abridgment of the priority. The only changes of the right made by statute have been by way of enlarging its scope in certain cases."

In the case of United States vs. Birmingham Trust & Savings Co., 258 Fed. 562, the Circuit Court of Appeals for the Fifth Circuit speaks as follows, respecting the federal sovereignty for the collection of taxes:

> "The right of the United States to present a claim in a bankruptcy case at any time while the bankruptcy is pending and the funds thereof are not distributed cannot be questioned."

This right is of equal dignity to that of the State right. The quotation applies in all its vigor to the instant case. (See also *In re* Brezin, 297 Fed. 300.)

In Lewis vs. United States, 92 U. S. 618, this Court held that the Federal Government was not bound by the bankruptcy statute applicable to the limitation of filing of

ordinary claims and that it was the duty of the trustee in bankruptcy to ascertain and have paid any taxes that may be due and owing.

The sovereign right is aptly referred to by the Circuit Court of Appeals for the Third Circuit in Wechsler vs. United States, 27 Fed. 2nd 850, as follows:

> "The government is not bound to go into the bankruptcy Court, and its debts is not barred by a discharge in bankruptcy, but in order to secure a priority of payment out of a composition fund, the claim must be filed in the Court. Failure to do so, with full knowledge of the composition proceedings, before the fund is entirely distributed, waives such right, and leaves no ground on which to hold the trustee, or any person appointed to distribute the fund, liable out of his private estate; but having filed its claim before the composition fund is exhausted, the claims, if allowed, may now be paid out of this fund to the extent of the undistributed balance."

Bar orders or orders of foreclosure are therefore limited in effect, to insure safety of distribution. In this regard they are like the early orders of the same kind in the administration of a decedent's estate. (Gillespie vs. Alexander, 3 Russell, 130, 136.) If the federal government or the state is served with a bar order, and fails to file its proof of claim, and thereafter distribution is made, while the sovereign right itself is not destroyed, there will be construed to have occurred a waiver of such right as to the assets distributed under the order of the Court. But as to undistributed assets existing at the time the claim is filed, the sovereign right attaches and cannot be constitutionally judicially affected.

The foregoing result accords with sound principle.

A sovereign State, in enforcing its obligations, is bound by no statute of limitations, unless expressly in-

cluded by explicit statutory language. (U. S. vs. Corona Coal Co., 264 U. S. 578; Grand Trunk Western Railroad Company vs. U. S. 252 U. S. 112; Chesapeake etc. Canal Co. vs. U. S., 250 U. S. 250; People vs. Clarke, 9 N. Y. 349.) The doctrine of laches does not apply to any action by the State to enforce or preserve the public revenue. (Terra Haute etc. R. R. Co. vs. The State, 159 Ind. 438; Josselyn vs. The State, 28 Miss. 758; Haehnton vs. Corn, 13 Pa. St. 617; State vs. Columbia, 52 S. W. Tenn. 511; State vs. Sponagle, 45 W. Va. 415; *Re* Mosley, 100 Kans. 495; State vs. Lumber Co., 122 Minn. 400.) With the State being in a position, therefore, to present its claim for taxes at any time without limitation or without being guilty of laches, it would, of course, render distribution of a bankrupt's estate impossible unless a limitation was prescribed at the end of which time the Court could imply a waiver in connection with a distribution of the estate. The practice of issuing bar orders was only intended to accomplish this result. In no other respects was it intended to affect, nor could it constitutionally affect, the sovereign right of the State to collect the public revenue. If the State does not file its claim before the expiration of the time limit in the bar order, a waiver may be implied unless the State files and brings the same to the attention of the Court before actual distribution of the estate. For any prior laches or delay of its officers, the State remains unaffected.

No estoppel could arise against the State. The elements of an estoppel are, of course, that one person, by his conduct, has induced another to believe in the existence of a particular state of facts on which action is taken to the latter's prejudice. But the State, in the instant case, made no representations as to the existence or non-existence of any tax liability. Inquiry by the trustee would have dis-

closed the possibility of the accrual of the tax liability for which the claim was filed. There has been no prejudice to anybody. No final distribution of the estate has been made. There has been no reliance upon the silence of the State which has resulted in any action prejudicial to any interest. *The estate is in the same condition as it would have been had the State filed its claim within the limitation of time prescribed by the bar order.* Therefore, the elements of an estoppel are entirely lacking.

POINT II.

In the absence of payment of final dividend on the estate of the bankrupt, the unliquidated claim of the State of New York for additional franchise taxes must be allowed, even though filed after the expiration of the time limitation prescribed in the bar order.

The period of time prescribed in the bar order for the filing of any claims for taxes by the State of New York was sixty days after the service of a copy of said order. This time expired September 16th, 1929. The claim in question was filed by the State with the Referee October 20th, 1929, one month and two days after the expiration of said time limitation. At that time the claim was received by the Referee and placed on file. No final distribution of the bankrupt's estate had then been made and it cannot be contended that the late filing of the claim has resulted in any prejudice. The motion of the trustee in bankruptcy to expunge the claim was made in April, 1931, a year and a half after the claim was filed and apparently allowed for consideration on the merits.

In expunging the claim on the ground that the same was filed after the expiration of the time limitation pre-

scribed by the bar order,—an order issued not under any statutory authority but solely under a Court rule to permit the final accounting and distribution in bankrupt estates,—both the Court below and the referee fell into error in failing to take the fact into account that the liability to pay taxes to a sovereign State continues after the appointment of either a receiver or trustee until the period of actual distribution. (State of New Jersey vs. Anderson, 203 U. S. 483.) As stated in Prince vs. Walters, 131 Fed. 546, 550:

> "But the bankruptcy act does not withdraw the estates of bankrupts from the reach of the taxing powers, and they are subject, in consequence, to the payment of taxes imposed while they are in the hands of trustees, the same as if they were not. (Swarts vs. Hammer, 120 Fed. 256, affirmed 194 U. S. 441; City of Waco vs. Bryan, 127 Fed. 79; *In re* Sims, 118 Fed. 356; *In re* Conhaim, 100 Fed. 268; *In re* Keller, 109 Fed. 131.) Even though accruing after bankruptcy, they must be regarded as within the meaning of the statute and entitled to priority, the same as those which antedated it. They are equally important to the municipalities to which they are due whenever assessed, and the obligation of the property to respond is logically no different or greater at the one time than at the other."

The reason for the rule is particularly pertinent in a case like the present where the object of the claim is to have the referee determine the correct amount which the corporation should pay to the State for its previous enjoyment of corporate life. The continuance of such life is the result of the gift of the State, which permits such continuance in consideration of a fixed annual charge of franchise tax, based first upon the reports of net income filed by the corporation, and subject to subsequent increase upon such income being increased by the Federal

Government in the returns of the corporation filed with the latter. As stated in New Jersey vs. Anderson, 203 U. S. 483:

> "The State which created this corporation had the right to fix the terms of its existence, and provide, if it saw fit so to do, that for the continued existence of its franchise, the corporation should pay the annual sums to the State, fixed by the amount of its yearly outstanding capital stock."

The same conception of continuous annual liability during the life of the corporation is the nucleus of the decision in People vs. Jersawit, 263 U. S. 493.

The legal effect of the bar order was simply and solely to permit a distribution, partial or entire, to be made of the bankrupt's estate, with a release of possible tax liability claim for which claim had not been filed before such distribution is affected. And in previous decisions, in which this subject received consideration, bar orders have been limited accordingly.

Employers Liability Assurance Corporation vs. Astoria Mahogany Co., 6 Fed. 2nd 945, was a decision by this Court, where a creditor was permitted to file a claim after the expiration of a time limitation in a bar order, where the only thing that could be said in opposition, as in the instant case, that the allowance of such claim would swell the total amount of the filed claims, the intent of the order being to prevent prejudice in any administration of the bankrupt's estate made without knowledge of the possible existence of the claim. (In accord, *Re* Coulter, 206 Fed. 906; *Re* Bell Piano Co., 155 Fed. 272.)

In People vs. Hopkins, 18 Fed. 2nd 731, the Court held that the limitation of a bar order did not preclude the

State from subsequently filing a claim for taxes, providing, at that time, no distribution of the bankrupt's estate had been made. Judge Swan, writing the opinion of this Court, stated, page 732:

> "The effect of such so-called bar order is merely to protect the receiver in making distribution without regard to possible claims of creditors who have failed to file them. If, before distribution is actually made, a creditor appears and satisfies the Court that he is justly entitled to share in the assets on hand, his delay in presenting the claim should not bar him unless some one has been injuriously mislead thereby. * * * Particularly should this be true with respect to taxes. The assets are still *in custodia legis* and should bear their share of the public dues despite the state's delay in asserting its claim."

The Court then further held that a motion to compel the referee to receive the state's claim for taxes must be granted, even though the state had been specifically ordered to present any claim which it had for taxes within a specified time, Judge Swan further stating, page 733:

> "The assets still remain in the hands of the receiver. Had a motion to vacate been made, we think it should have been granted, and it seems to us immaterial that the state presented its claim by an independent application instead of by motion to vacate."

In Re Anderson, 279 Fed. 525, relied on by respondent, a proceeding in bankruptcy, the Court simply held that the United States could not stand by after permission having been granted to file its claim and expect to subsequently collect its claim from the bankrupt or his trustee. To permit such a proceeding would make it impossible to say when there would be a winding up of the bankruptcy proceeding and a distribution of the assets. This is good law and the proper rule for the management of estates; but

the facts in the Anderson case are not the same and do not apply to the proceeding herein.

In the Anderson case, notice was given to the Collector to file the claim of the United States or to be forever barred, and notwithstanding such notice, the United States neglected or, in any event, failed to pay heed to the mandate of the Court to file its claim and simply took the position that the referee and the Court were without power to grant an order barring the sovereign, which is entirely different from the attitude of the State of New York in the proceeding herein.

The State of New York has filed no formal proof of claim in a definite amount for the good and sufficient reason that it is not in a position so to do at this time, as aforesaid, and the notice of claim filed herein is only for the purpose of advising the trustee of such possible claim, in order that he might assist and cooperate to the end that all taxes legally due and owing shall be paid.

Consequently, the bar order in this case is really barring taxes that have not actually accrued or been levied and surely it is not within the province of a bar order to bar future taxes that may or may not accrue.

In Re BATES MACHINE & TRACTOR CO., 8 Fed. 2nd, 424, in which case the facts are somewhat similar to the present case under review, Judge Wilkerson, speaking of the Anderson case, said:

> "There a tax had been levied more than two years prior to the filing of the petition by the trustee, and the trustee claimed that the tax had not been properly laid. The United States never filed any proof of claim, and the entry of the order was necessary to the

exercise by the Court of its power under §64-A of the Bankruptcy Act (Comp. St. §9648). The estate cannot be closed until the validity of the tax which had been levied was determined. Here the additional tax was not levied until after the time fixed in the order of April 12, 1924, had expired, and the tax was levied and the claim was filed long before the time for the declaration of the final dividend under §65-B (Comp. St. §9649) had expired.

We are not dealing here with the power of the Bankruptcy Court to require the United States to bring forward claims based on taxes actually levied for the purpose of having questions relating to such claims adjudicated in the Bankruptcy Court. We are dealing with the power of the referee, acting under §64-A, to cut off the United States as to additional taxes levied pursuant to the Revenue Laws after a specified time, and to deprive the United States of its right to have such taxes paid out of any funds which may remain in the possession of the trustee. It must be borne in mind that in many cases, the basis for the additional levy is not disclosed until after the books and papers of the bankrupt have come into the possession of the trustee. The exercise of the power here asserted by the referee would operate, in many cases, to prevent the United States from recovering revenue out of which it has been defrauded by a false return. It must be borne in mind that the claims of the United States for taxes are not affected by a discharge in bankruptcy. They are not debts, but imposts levied for the support of the government. The government's claim is in the nature of an equitable lien, and follows the property into the hands of the trustee in bankruptcy, where it awaits satisfaction. *Re-Brezin,* (D. C.) 297 F. 300, 306.

The question of the rights of the United States in cases where it fails to assess the tax until after the funds in the hands of the trustee have been paid out under §65-B is not involved here. We are dealing with the power of the referee to enter the general order barring the United States, and with the right of the United States to file its claim for the additional taxes, and to have them paid out of whatever funds remain in the hands of the trustee.

It is my opinion that §64-A does not confer upon the referee power, express or implied, to make the order of April 12, 1924, and that the order, when applied to the claim for the additional taxes for 1919 and 1920, is void. It is my opinion, further, that the claim of the United States filed June 14, 1924, was properly filed, and that it should be heard by the referee on its merits. * * * * * * * * The Bankruptcy Court and the trustee, of course, have a duty to perform to creditors. They owe a duty also to the United States. That duty is one of cooperation and assistance in the collection of taxes levied for the support of the government. The statute casts that duty upon the trustee in no uncertain terms."

In the case of *Villere v. United States, in re John P. Rausch Co. Inc.*, 18 Fed. 2nd 409, speaking of the Anderson case, *supra*, the opinion states:

"The case of *In Re* Anderson, 279 Fed. 525, relied upon by the appellant does not attempt to hold contrary to the general rule. * * * * * * It is not applicable to the instant case, as the government is not seeking to reopen the provisional account, and makes no claim to the assets previously distributed."

In Re Brezin, *et al.*, 297 Fed. 300, Runyan, District Judge:

"The Anderson Case, while seeming to hold to the contrary, really goes no further than to rule that the government cannot, after notice indefinitely refuse to present its claim. * * * * * * The departure in public policy noted consists in giving the federal courts jurisdiction as to the amount or legality of any tax, and apparently putting the United States on a par with other taxing divisions. Section 64-A expressly recognizes priority *and is silent as to any limitation of time, simply making it mandatory that the Courts shall order the payment of taxes in advance of payments to creditors.*"

POINT III.

It is the duty of the Referee to allow the State's claim in accordance with a reaudit of income taxes due the Federal Government.

The bankrupt made a report of income for the tax years beginning November 1st, 1917 to 1928 inclusive. Taxes were levied in accordance with the returns thus filed, with respect to which there is no question on this appeal. But under Section 219-d of the Tax Law of the State of New York, the federal final adjustment of income is taken as the basis of the correct franchise tax payable to the State. The unliquidated claim of the State is in effect merely a caution or advice of a possible further claim for franchise taxes dependent upon the ascertainment of additional taxable income as determined in the matter of taxes due the federal government. The state cannot do anything further but to file the claim until the claim of the federal government is determined in this proceeding.

The referee has the legal right to determine the correct amount of net income for the tax years and audit and readjust the claims of the federal government.

In 1929 the State had, in effect, stated to the referee, that it had made franchise tax assessments which were subject to possible increase dependant upon what action was taken with respect to federal income taxes. Thereupon it became the duty of the referee to fix and determine the true net income for the tax years in question and determine the extent of the claim of the national government. When this was done, the claim of the State became necessarily fixed and determined.

Nothing the State did or could do after the filing of the unliquidated claim delayed the closing of this estate. The referee had the power to and should determine the federal government claims. No reason is advanced why this had not been done long ago. Had it been, the claim of the State would have also been liquidated, settled and determined. For what the trustee or referee has neglected to cause to be done, neither the State nor any of its officers or departments can be said to be responsible. The State's claim had been permitted to remain on file for upward of a year and a half before the trustee moved to expunge it because it had been so filed a little over a month after the time limited in the order, at which time final administration of the estate was far from completion.

The Bankruptcy Act places a responsibility upon the trustee when it directs him to pay all taxes legally due and owing and that mandate does not mean simply to petition the Court for bar orders, but rather means that it is the duty of the trustee to use every means at hand to search out from books and records of the bankrupt or its successors in interest, and from such books and records to ascertain and make known to the taxing authorities information that will enable the taxing authorities to file proper proof of claim, to the end that all taxes will be paid. This, the trustee has not done in this case, as will be disclosed from a reading of the correspondence offered in evidence herein. On the contrary, it appears to be the attitude of the trustee to do nothing to aid the State of New York in obtaining sufficient facts and figures to determine what taxes and their amounts, if any are due. And while it is perfectly proper and equitable that bar orders be used for the purpose of protecting the trustee and preventing unnecessary delays in the winding up of the affairs of the estate, or to

prevent any injustice to other persons or creditors, there must be no abuse in the use of such bar orders and extreme caution and care should be taken before foreclosing the rights of the sovereign in the collection of its taxes.

There is nothing in the Bankruptcy Act * * * which exempts property in the hands of a trustee in bankruptcy from the State and Municipal taxes to which similar property in the same locality is subject.

By Section 7 of that Act, the title to all of the property of the bankrupt not declared to be exempt is vested in the trustee. By the transfer to the trustee *no mysterious or peculiar ownership* or qualities are given to the property. It is dedicated, it is true, to the payment of the creditors of the bankrupt, but there is nothing in that to withdraw it from the necessity of protection by the State and Municipality, or which should exempt it from its obligations to either. If Congress has the power to declare otherwise and wished to do so, the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt. *(Swartz v. Hammer,* 194 U. S. 441.)

> "Orders of foreclosure are primarily intended for no more than safety in distribution. In this regard they are like the early orders of the same kind of the English Court of Chancery in the administration of a decedent's estate. *Gillespi v. Alexander B. Russell,* 130, 136. They enable the receivers to dispose of the property, *but not to forfeit the rights even of dilatory creditors.* That delay may be enough we do not deny, but certainly not unless the result of allowing the claim is to destroy intermediate interests, arising on the faith of creditors' inaction." * * * * "nor can we see that the appellant was under any duty to advise the receivers upon the first intimation in August, 1922

that it might have a claim. The transactions were manifold, and complicated; first suspicions might prove groundless." *Employers Liability Assurance Corporation, Ltd. v. Astoria Mahogany Co., Inc.*, 6 Fed. 2nd 945.

"It is the duty of the trustee to search for taxes and pay those which are legal. Section 64-A of the Bankruptcy Act. Consequently claims for taxes need not be verified and no formal proof of claim is required." *In re: DeAngeles*, 36 Fed. 2nd 218; *Standard v. Dayton*, 220 Fed. 441.

"Back taxes are to be paid, even though they absorb all or a great part, of the assets; and even though the tax collectors have been neglectful in making collection." *In Re: Weissman*, 24 A. B. R. 150, 178 Fed. 115.

City of Dallas v. Menezes, 16 Fed. 2nd 779 (C. C. A.) holding the trustee personally liable if a refund could not be obtained from the creditors to whom the estate had been distributed.

In Re Chandler Motors of New England, Inc., 17 Fed. 2nd 998, Morton, District Judge, held:

"It is the duty of the trustee under Bankruptcy Act, §64-A (Comp. St. §9648) to pay all taxes legally due upon their being called to his attention. The trustee contends that the running of the statute, not merely prevented the government from taking legal steps to collect the tax, but extinguished its right to the tax —an old question of theoretical law, about which, in different forms, there has been much discussion, which I do not propose to extend. The trustee holds the estate in trust for various purposes, one of them being to pay lawful taxes. No proceedings by the government with respect to this tax was required, except such as might be necessary in order to fix the proper amount of it. Under such circumstances, the government's right to the tax was clearly not lost by the failure to file proof of claim."

With the duty of the trustee thus well defined, with the referee having power to make an adjudication, at the instance of the trustee, which would be decisive of the entire situation, the responsibility of not having both the claims of the federal government and the State settled and determined is not that of the State.

CONCLUSION.

It is respectfully submitted that the petition for certiorari should be granted as prayed for.

Respectfully submitted,

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